

## Executive Summary

On April 16<sup>th</sup> USAID hosted Dr. Ha-Joon Chang to discuss his book, Kicking Away the Ladder: Development Strategy in Historical Perspective,<sup>1[1]</sup> which was awarded the 2003 Myrdal Prize. Dr. Chang used historical evidence to demonstrate that the policies and institutions developing countries are currently being encouraged to adopt are not the ones that successfully developed countries employed in their own development. Current prescriptions for developing countries are based on an orthodoxy about how democratic capitalism has developed that is largely untrue. He concluded that the implications of this discrepancy are:

- Donors should reconsider the utility of particular policies, such as free trade, for the weakest part of the developing world.
- Donors need to distinguish between institutions that are catalysts for development and those that are products of development. Many institutions found in developed countries are the result of rather than the causes for economic growth.
- Prioritizing among institutions that developing countries are urged to establish is essential, given the cost in scarce local resources.
- Donors should pay more attention to *function* than to *institutional form*. The developed world shows that there are multiple institutional solutions to problems in developing countries.
- More research is needed on how institutions develop and how they work together.

## Introduction

April 16<sup>th</sup> PPC invited Dr. Ha-Joon Chang to discuss the key finding of his book, Kicking Away the Ladder, with an audience at USAID. Dr. Chang began by outlining the current agreement that developing countries should adopt a set of good policies and institutions in order to facilitate economic development, known as the Washington Consensus. These include conservative macro-economic policies, liberalization of trade and investment flows, privatization of state firms and termination of subsidies of all sorts. Chang used historical evidence to argue that successfully developed countries did not use the policies in their own development that they press developing countries to adopt. Instead, donor prescriptions for development reflect their current policies and practices rather than their own developmental experience.

Chang divided his remarks into two parts:

### I. Trade/Industrial Policies

Chang described the trade, industrial and economic policies used by developed countries during their development process. He offered the following evidence to support his claim that few developed countries used the policies that they currently advocate:

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<sup>1[1]</sup> The title of the book stems from a quote by the 19<sup>th</sup> century German economist Friedrich List who concluded from British behavior that developed countries try to “kick away the development ladder” by pushing developing countries to adopt free trade policies.

- In the 19<sup>th</sup> century Great Britain had the highest tariff rates on manufactured goods in the world. In addition, it used import substitution, infant industry protection, export subsidies and import tariff rebates
- The United States also had high tariffs until after WWII, when its economic primacy was assured.
- To date, most other developed countries used a mix of infant industry promotion, export subsidies and tariff barriers in earlier stages of development. The Netherlands and Switzerland were two exceptions to this pattern that Japan and the Asian Tigers have followed. China continues a similar approach today
- Free trade is beneficial among countries at a similar level of development; not among those at very different levels.

## **II. Institutions**

Chang turned to the recent introduction of institutions into the advice offered to developing countries--the so-called “Augmented Washington Consensus.” He separated institutions into six categories and examined each individually in terms of when and how they were adopted by developed countries. The categories he used were:

1. Democracy
2. Bureaucracy
3. Property Rights
4. Corporate Governance
5. Financial Institutions
6. Welfare and Labor Institutions

Using examples from the development experiences of the United States, Great Britain and Western Europe, Chang demonstrated that institutions currently taken for granted were in fact slow to develop. For instance, until 1913 the United States had no independent central bank nor did Switzerland have a patent system. Universal suffrage was not widespread until the middle of the 20<sup>th</sup> century. Nepotism and corruption were defining features of most bureaucracies until the late 19<sup>th</sup> century. Lack of judicial independence was the norm. The role of property rights was ambiguous. Overall the institutions, today deemed essential for economic development, were not present in developed countries while they were developing.

Moreover, Chang highlighted the expense of creating effective institutions. He pointed out that many, even economists, overlook the substantial costs in terms of scarce resources of establishing institutions. For example, setting up an effective legal system might divert thousands of educated people away from education or health care. Therefore donors and developing countries should rank institutions in order of need to determine how best to expend their scarce capital.

## **Conclusions**

From this evidence Chang draws several conclusions:

- Many institutions are the result of rather than the catalyst for economic growth;

- Developing countries and donors must prioritize institutions, distinguishing essential from dispensable. Scarce resources make it unrealistic for developing countries to establish the full panoply of institutions found in developed countries.
- Effective institutions take a long time to develop.
- Today's developed countries were less institutionally developed than current developing countries at a similar stage of development
- Function is more important than institutional form. Successful developers exhibit a wide variety of institutions to accomplish the same function. . The difference in bankruptcy laws between the United States and Great Britain is just one example.
- More research on how institutions are created and how they work together is needed.

### **Discussion**

A variety of questions and issues were raised during the discussion period. Among them:

- Protectionism is not mercantilism; some protectionist measures are proven effective and useful. Chang argued that industry promotion more accurately captures a heretofore successful development strategy.
- China is a current example of a developing country enjoying a high rate of growth without adopting the "Augmented Washington Consensus"
- USAID's extensive field experience and presence should be used to collect information about institutions--how they are formed and the variety they can take
- Developing countries should be presented a menu of institutional options to solve specific problems
- Political leadership is a vital component in development

Imported institutions can be successful if adapted to local customs and conditions. Japan is a case in point.